

SENIOR "WIPE-OUTS" OF HOA DELINQUENT ASSESSMENT LIENS
(including a section on what to do afterwards)

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Your board may have been the recipient of the bad news that your association's assessment lien has been "wiped-out" by a senior foreclosure. That's right - wiped off the property, extinguished and obliterated out of existence. How can such a thing happen? The answer is deeply rooted in California law with cases going back at least as far as 1860! Back then, in the case of McDermott v. Burke, (1860) 16 Cal.589, the California Supreme Court held that a lease entered into after a mortgage was placed on property was extinguished by a foreclosure sale conducted by the mortgagee (lender). Not too long thereafter, in 1906, the Supreme Court held in Weber v. McCleverty, 149 Cal. 316, that when a property is sold under a deed of trust, the purchasers acquire title free and clear of all encumbrances subsequent to the deed of trust.

The logic behind these decisions, and the many others that have followed over the years, seems clear. When a mortgagee (lender) takes real property as security for a loan, its security should not be diminished or eliminated by the subsequent actions of the mortgagor (borrower) over which the lender has little or no control. If the borrower could place a second mortgage on the property which would remain after the senior foreclosure, the senior lender, upon repossessing the property, would receive back its security impaired by the remaining junior lien. Not only would this be unfair and defeat the expectations of the parties, but, the practical effect would be that no loans would be made by lenders to begin with and, therefore, all properties would have to be sold for cash only. Given today's markets, that may not be a bad idea, but it would not be an exaggeration to say that, in the past, financing of real estate purchases paved the way for the development and expansion of California and the rest of the nation.

The law of senior wipe-outs is inexorably entwined with the laws of lien priority. In California, the rules are simple: the first lien recorded with the County Recorder in the county where the property is located has the highest priority. All remaining liens take their relative priority from their date of recording. Therein lays the problem for HOA assessment liens. Such liens, by law, (Civil Code Section 1367.1(d)) can only be recorded after assessments become delinquent and no sooner. Thus, acquisition mortgages, known as deeds of trust in California, almost always record well before assessments become delinquent and are, therefore, almost always senior liens looming over later recorded assessment liens (and second mortgages, for that matter). The foreclosure of the first and most senior trust deed will wipe out everything recorded after. Of course, the government has managed to make property taxes senior to even a first trust deed so property taxes are unaffected by first trust deed foreclosures. Everything else "ceases to exist" as the court put it in Strieff v. Darlington, (1937) 9 Cal. 2d 42.

There has been no erosion of this doctrine in more recent cases. They all reiterate, as, for example, in Dover Mobile Estates v. Fiber Form Products Inc. (1990) 220 Cal. App. 3d 1494, "Liens which attach after execution of foreclosed trust deed are extinguished. The purchaser at the trustee sale therefore takes title free of those junior or subordinate liens." This same court explains the doctrine this way: "Title conveyed by a trustee's [foreclosure] deed relates back to the date when the deed of trust was executed. The trustee's deed therefore passes title held by the trustor [borrower/owner] at the time of execution."

If your association's assessment lien is "wiped-out" by a senior sale (and remember, the senior must actually complete its sale to affect a wipe-out) all is not lost. The association loses the security for the delinquent assessments (the property) but the debt remains. The security is lost but the obligation of the delinquent owner still exists. Therefore, the association can pursue the owner on an unsecured basis by suing the owner (now prior owner) in Small Claims Court or in Superior Court. Judgments obtained in these court proceedings can be executed upon by wage garnishments and other means or can become liens on other real property owned or purchased in the future by the delinquent owner, if any. Thus, ultimately, by recordation of a document called an Abstract of Judgment, the association with a court judgment could regain its status as a secured creditor on another property.

It was always best to have security for an obligation and California law gives homeowners associations a special right to become secured by recording assessment liens (Notices of Delinquent Assessment) against the delinquent owner's property. Foreclosure of such liens carries the greatest chance of obtaining payment for the association or terminating the ownership interest of the defaulting owner. However, if the association does suffer a "senior wipe-out", pursuit of the prior owner in court can still be a viable option.

This article is of a general nature. Consult your association's general counsel for more information and for legal advice. Richard G. Witkin can be reached at Witkin & Neal, Inc at (818) 845-8808 or by e-mail to rwitkin@charter.net.